

thereof, prescribed by law for filing the income tax return for such taxable year or 180 days after the date of publication of this notice as a Treasury decision, whichever occurs last. If a taxpayer makes an election (or revokes an election under subdivision (ii) or (iii) of this subparagraph (b) (2)) for a taxable year for which he or she has previously filed a return, the return for that taxable year and all other taxable years affected by the election (or revocation) must be amended to reflect any tax consequences of the election (or revocation). However, no return for a taxable year for which the period for filing a claim for credit or refund under section 6511 has expired may be amended to make any changes other than those resulting from the election (or revocation). In order for the election (or revocation) to be effective, the taxpayer must remit with the amended return any additional tax due resulting from the election (or revocation), notwithstanding the provisions of section 6212(c) or 6501 or the provisions of any other law which would prevent assessment or collection of such tax.

(b) *Statement required when making election.* The statement required when making the election must clearly indicate that the election to treat outdoor advertising displays as real property is being made.

(ii) *Revocation of election by Commissioner's consent.* Except as otherwise provided in paragraph (b)(2)(iii) of this section, an election under section 1033(g)(3) shall be irrevocable unless consent to revoke is obtained from the Commissioner. In order to secure the Commissioner's consent to revoke an election, the taxpayer must file a request for revocation of election with the Commissioner of Internal Revenue, Washington, D.C. 20224. The request for revocation shall include—

(A) The taxpayer's name, address, and taxpayer identification number,

(B) The date on which and taxable year for which the election was made and the Internal Revenue Service office with which it was filed,

(C) Identification of all outdoor advertising displays of the taxpayer to which the revocation would apply (including the location, date of purchase, and adjusted basis in such property),

(D) The effective date desired for the revocation, and

(E) The reasons for requesting the revocation.

The Commissioner may require such other information as may be necessary in order to determine whether the requested revocation will be permitted.

The Commissioner may prescribe administrative procedures (subject to such limitations, terms and conditions as he deems necessary) to obtain his consent to permit the taxpayer to revoke the election. The taxpayer may submit a request for revocation for any taxable year for which the period of limitations for filing a claim for credit or refund or overpayment of tax has not expired.

(iii) *Revocation where election was made on or before December 11, 1980.* In the case of an election made on or before December 11, 1979, the taxpayer may revoke such election provided such revocation is made not later than March 23, 1981. The request for revocation shall be made in conformity with the requirements of paragraph (b)(2)(ii), except that, in lieu of the information required by paragraph (b)(2)(ii)(E), the taxpayer shall state that the revocation is being made pursuant to this paragraph. In addition, the taxpayer must forward, with the statement of revocation, copies of his or her tax returns, including both the original return and any amended returns, for the taxable year in which the original election was made and for all subsequent years and must remit any additional tax due as a result of the revocation.

(3) *Definition of outdoor advertising display.* The term "outdoor advertising display" means a rigidly assembled sign, display, or device that constitutes, or is used to display, a commercial or other advertisement to the public and is permanently affixed to the ground or permanently attached to a building or other inherently permanent structure. The term includes highway billboards affixed to the ground with wood or metal poles, pipes, or beams, with or without concrete footings.

(4) *Character of replacement property.* For purposes of section 1033(g), an interest in real property purchased as replacement property for a compulsorily or involuntarily converted outdoor advertising display (with respect to which an election under this section is in effect) shall be considered property of a like kind as the property converted even though a taxpayer's interest in the replacement property is different from the interest held in the property converted. Thus, for example, a fee simple interest in real estate acquired to replace a converted billboard and a 5-year leasehold interest in the real property on which the billboard was located qualifies as property of a like kind under this section.

PART 7—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1976

Par. 5. Paragraph (c)(6) of § 7.0 is hereby removed.

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26 CFR Parts 25 and 301

[T.D. 7757]

Gift Taxes; Gifts Made After December 31, 1954 and Procedure and Administration—Filing of Gift Tax Returns; Furnishing Statement Explaining Estate or Gift Valuation

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the time for filing gift tax returns and for requesting a statement explaining valuation for estate, gift or generation-skipping transfer tax purposes. Changes to the applicable law were made by the Tax Reform Act of 1976 and the Act of December 29, 1979. The regulations would provide the public with the guidance needed to comply with those acts. In addition, this document contains an amendment to a regulation relating to the exercise of a general power of appointment.

DATES: The amendments are generally effective for gifts made after December 31, 1976.

FOR FURTHER INFORMATION CONTACT: Robert H. Waltuch of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

Background

On December 19, 1979, the Federal Register published proposed amendments to the Gift Tax Regulations (26 CFR Part 25) under sections 2514 and 6075(b) and to the Procedure and Administration Regulations (26 CFR Part 301) under section 7517 of the Internal Revenue Code of 1954 (Code) (44 FR 75185). These amendments were proposed to conform the regulations to section 2008(a)(2) and (b) of the Tax Reform Act of 1976 (90 Stat. 1891 and 1892) relating to the special rule for filing returns where gifts in a calendar quarter total \$25,000 or less. In addition, the final regulations conform the regulations to section 8 of the Act of

December 29, 1979 (93 Stat. 1277), which provides that the due date for filing a gift tax return for the fourth calendar quarter or the calendar year is April 15 of the following calendar year. The amendments are issued under the authority contained in section 7805 of the Code (68A Stat. 917; 26 U.S.C. 7805). Section 25.2514-1 of the Gift Tax Regulations is also amended to clarify the effect of an exercise of a lifetime nongeneral power of appointment by a person when that person also has a lifetime general power of appointment over the same property.

Summary of Comments and Final Regulations

Exercise of General Power of Appointment

Under the proposed regulation, if a person had both a presently exercisable general power of appointment over all or a portion of a trust's corpus and a nongeneral power of appointment over the entire corpus of the same trust and the person exercised the nongeneral power, such an exercise resulted in the exercise of the general power.

Two comments were received regarding this proposed amendment. The first commentator was not in favor of making any change at all. However, if a change were to be made, the commentator believed that it should be made under paragraph (d) of § 25.2514-1 relating to the definition of exercise rather than under paragraph (c) of that section, relating to the definition of a general power of appointment. The second comment was in favor of the proposed amendment, but felt that the amendment was too broad. After carefully considering these comments, the final regulations have been revised by amending paragraph (d) and by narrowing its scope.

Under the final regulations, if a person has a presently exercisable general power of appointment over all or a portion of the corpus of a trust and a nongeneral power of appointment over all or a portion of the same trust the exercise of the nongeneral power is treated as the exercise of the general power to the extent that the amount of money or property subject to being transferred by the exercise of the general power has been reduced by the exercise of the nongeneral power.

Due Date for Gift Tax Returns

Two comments also addressed the proposed amendment to § 25.6075-1, relating to time for filing gift tax returns. The first commentator requested that the amendment be revised to make it clear that separate returns for each

quarter must be filed. This change has not been made. However, the final regulations do make it clear that a return encompassing more than one quarter must meet all the requirements for a separate return had one been required for each quarter.

The second commentator requested that the effect of section 2513, relating to split gifts, be addressed in the final regulations and that § 25.2513-1(c) and (d) be revised. The effect of section 2513 is addressed in the final regulation. Under the final regulation, the effect of section 2513 is only taken into account for prior gifts if an irrevocable consent was made on a return required to be filed prior to the due date of the current return. Section 25.2513-1 (c) and (d) have not been revised because those paragraphs are correct as written. Section 6075(b) of the Code does not change the fact that a return is due for a particular quarter. It merely changes the date that the return is due.

Technical Amendment to 26 CFR Part 301

This Treasury decision also makes a technical amendment to § 301.6103 (l)(2)-(3)(a) of the Regulations on Procedure and Administration to relocate a misplaced sentence.

Drafting Information

The principal author of this regulation is Robert H. Waltuch of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Parts 25 and 301 are amended by adopting, subject to the following changes, the regulations proposed as a notice of proposed rulemaking published in the *Federal Register* on December 19, 1979 (44 FR 75185).

Paragraph 1. Paragraph 1 of the notice of proposed rulemaking is revised to read as follows:

Section 25.2514-1 is amended as follows:

(a) The last sentence of paragraph (c) (1) is revised to read as set forth below.

(b) Paragraph (d) is amended by adding four sentences after the last sentence in the paragraph to read as set forth below.

§ 25.2514-1 *Transfers under power of appointment.*

(c) *Definition of "general power of appointment"*—(1) *In general* * * * The latter power is not a general power of appointment (but its exercise may result in the exercise of the former power; see paragraph (d) of this section).

(d) *Definition of "exercise."* * * * Furthermore, if a person holds both a presently exercisable general power of appointment and a presently exercisable nongeneral power of appointment over the same property, the exercise of the nongeneral power is considered the exercise of the general power only to the extent that immediately after the exercise of the nongeneral power the amount of money or property subject to being transferred by the exercise of the general power is decreased. For example, assume A has a noncumulative annual power to withdraw the greater of \$5,000 or 5 percent of the value of a trust having a value of \$300,000 and a lifetime nongeneral power to appoint all or a portion of the trust corpus to A's child or grandchildren. If A exercises the nongeneral power by appointing \$150,000 to A's child, the exercise of the nongeneral power is treated as the exercise of the general power to the extent of \$7,500 (maximum exercise of general power before the exercise of the nongeneral power, 5% of \$300,000 or \$15,000, less maximum exercise of the general power after the exercise of the nongeneral power, 5% of \$150,000 or \$7,500).

Par. 2. Section 25.6075-1 as set forth in paragraph 2 of the notice of proposed rulemaking is amended as follows:

(a) Paragraphs (a) and (b) are revised to read as set forth below.

(b) Paragraphs (c) and (d) are redesignated (d) and (e) respectively and a new paragraph (c) is added to read as set forth below.

§ 25.6075 *Returns, time for filing gift tax returns for gifts made after December 31, 1976.*

(a) *Due date for filing quarterly gift tax returns.*—(1) Except as provided in paragraph (b) of this section, a return required to be filed under section 6019 for the first, second, or third calendar quarter of any calendar year must be filed on or before the 15th day of the second month following the close of the calendar quarter in which the taxable gift was made.

(2) If a return is required to be filed under section 6019 for the fourth calendar quarter, then—

(i) For gifts made after December 31, 1976 and before January 1, 1979, the return must be filed on or before

February 15th following the close of the fourth calendar quarter, or

(ii) For gifts made on or after January 1, 1979, the return must be filed on or before April 15th following the close of the fourth calendar quarter.

(b) *Special rule.*—(1) If the total amount of taxable gifts (determined after the application of paragraph (c)(1) of this section, relating to split gifts) made by a person during a calendar quarter is \$25,000 or less, the return required under section 6019 for that quarter must be filed on or before the date prescribed in paragraph (a)(1) of this section for filing the return for gifts made in the first subsequent calendar quarter (unless the first subsequent calendar quarter is the fourth calendar quarter in which case see paragraph (b)(2) of this section) in the calendar year in which the sum of—

(i) The taxable gifts made during such subsequent calendar quarter, plus

(ii) All other taxable gifts made in prior quarters of the calendar year for which no return has yet been required to be filed,

exceeds \$25,000. The return must include transfers by gift (as required by section 6019 and the regulations under that section) made during such subsequent and prior quarters of the calendar year for which no return has yet been required to be filed and identify in which quarter such transfers were made. The return must meet all the requirements for a separate return as if a separate return had been made for each quarter in which a transfer by gift was made. This return will be treated as a separate return for each of the quarters identified on the return.

(2) If a return is not required to be filed under paragraph (b)(1) of this section, then—

(i) For gifts made after December 31, 1976 and before January 1, 1979, the return must be filed on or before February 15th following the close of the fourth calendar quarter, or

(ii) For gifts made on or after January 1, 1979, the return must be filed on or before April 15th following the close of the fourth calendar quarter.

The return must include all transfers by gift (as required under section 6019 and the regulations under that section) made during the calendar year for which no return has yet been required to be filed and identify in which quarter such transfers were made. The return must meet all the requirements for a separate return as if a separate return had been made for each quarter in which a transfer by gift was made. This return will be treated as a separate return for

each of the quarters identified on the return.

(3) Under section 6075(b)(3), any extension of time granted a taxpayer for filing the return of income taxes imposed by subtitle A for any taxable year which is a calendar year shall be treated as an extension of time granted the taxpayer for filing any return under section 6019 which is due (under paragraphs (a)(2)(ii) and (b)(2)(ii) of this section) on or before April 15th following the close of the fourth calendar quarter. See also section 6081 and § 25.6081-1 for other rules relating to extensions of time for filing returns.

(4) See section 7503 and § 301.7503-1 for the due date of a return that falls on a Saturday, Sunday, or a legal holiday. As to additions to the tax for failure to file the return within the prescribed time, see section 6651 and § 301.6651-1.

(c) *Effect of section 2513.*—(1) In determining whether taxable gifts made during any calendar quarter exceed \$25,000, and in determining whether taxable gifts made in the current calendar quarter and the preceding calendar quarters of the calendar year for which no return has yet been required to be filed exceed \$25,000, the effect of section 2513 is not taken into account for any gifts made in the current or previous quarters for which a return is now being filed unless an irrevocable consent was made by either spouse on a return that was required to be filed prior to the due date of the current return. See § 25.2513-3 for the rules relating to when a consent becomes irrevocable.

(2) Paragraph (c)(1) of this section may be illustrated by the following examples:

Example (1). During the first quarter of 1980 A made taxable gifts of \$17,000

(\$20,000—\$3,000 annual exclusion under section 2503 (b)) to D. During the second quarter A made another taxable gift of \$10,000 to D. A's taxable gifts for the first two quarters are \$27,000. Therefore, A is required to file a return for the first and second quarters on or before August 15, 1980. On that return A's wife, B, consented to the application of section 2513 (relating to split gifts) for the second quarter. Even though A split the second quarter gift with his wife, A's return is nevertheless required to be filed on or before August 15, 1980 because in determining whether taxable gifts exceed \$25,000, the effect of section 2513 is only taken into account for the quarter in which an irrevocable consent was made on a return required to be filed before August 15, 1980.

Example (2). Assume the same facts as in Example (1). In addition, during the third quarter A made another taxable gift of \$20,000 to D, and B made a taxable gift of \$24,000 to D. B is required to file a return reporting the taxable gifts made during the second and third quarters on or before November 15, 1980 because B's total taxable

gifts exceed \$25,000 (second quarter gifts after taking section 2513 into account = $\frac{1}{2}$ (\$10,000) — \$3,000 (annual exclusion under section 2503 (b)) = \$2,000 plus a \$24,000 gift in the third quarter). Even if A and B had consented to the application of section 2513 for the third quarter, B's return would nevertheless be due on or before November 15, 1980, because an irrevocable consent was not made on a return that was required to be filed prior to November 15, 1980. However, the effect of section 2513 is taken into account for the second quarter because an irrevocable consent was made on a return that was required to be filed prior to November 15, 1980.

Example (3). During the first quarter of 1980 A made taxable gifts of \$27,000 to F (\$30,000—\$3,000 annual exclusion under section 2503 (b)). A is required to file a return on or before May 15, 1980. A fails to file a return until August 1, 1980. On that return B, A's spouse, consented to the application of section 2513. The consent on that return is irrevocable under § 25.2513-3. During the second quarter B made taxable gifts of \$14,000 to F. A and B made no other gifts during 1980. B has made total taxable gifts of \$28,000 (\$12,000 for the first quarter and \$14,000 for the second quarter). Therefore, B is required to file a return on or before August 15, 1980. Even if A and B had consented to the application of section 2513 for the second quarter, B's return is nevertheless due on or before August 15, 1980. Assuming no other gifts were made during the year, A's return reporting the second quarter split gift would be due on or before April 15, 1981.

Example (4). During the first quarter of 1980 A made taxable gifts of \$20,000 to G. B, A's spouse, files a gift tax return on June 15, 1980 reporting that gift and both A and B signify their consent to the application of section 2513 on that return. In determining whether either spouse has exceeded the \$25,000 amount for the remainder of 1980, the effect of section 2513 will be taken into account for the transfer by gift made in the first quarter.

Par. 3. Section 301.6103 (l) (2)–(3) (a) of the Regulations on Procedure and Administration is amended by revising subparagraph (23) and the flush language following subparagraph (27). These revised provisions read as follows:

§ 301.6103 (l) (2)–(3) *Disclosure to Department of Labor and Pension Benefit Guaranty Corporation of certain returns and return information.*

(a) *Disclosures following general requests.* . . .

(23) Copies of initial pleadings indicating that the Service intends to intervene in a civil action under section 502 (h) of the Act;

Return information disclosed under this paragraph includes the taxpayer identity information (as defined in section 6103(b)(6)) of the plan or trust, the name

and address of the sponsor and administrator of the plan or trustee of the trust, and the name and address of the person authorized to represent the plan or trust before the Service. Disclosure of returns or return information as provided by this paragraph will be made only following receipt by the Commissioner of Internal Revenue of an annual written request for such disclosure by the Administrator of Pension and Benefit Welfare Programs of the Department of Labor or the Executive Director of the Pension Benefit Guaranty Corporation describing the categories of returns or return information to be disclosed by the Service and the particular purpose for which the returns or return information is needed in the administration of title I or IV of the Act, and designating by title the officers and employees of the Department of Labor or such corporation to whom such disclosure is authorized.

Par. 4. Paragraph (a) of § 301.7517-1 as set forth in paragraph 3 of the notice of proposed rulemaking is revised to read as set forth below.

§ 301.7517-1 *Furnishing on request of statement explaining estate or gift valuation.*

(a) *In general.* Section 7517 requires the Service to furnish to a taxpayer, at the request of that taxpayer, a statement explaining the estate, gift or generation-skipping transfer valuation of any item contained on a return filed by the taxpayer as to which a determination or proposed determination of value has been made. The request must be filed no later than the latest time to file a claim for refund of the tax which is dependent on the value with respect to which the determination has been made. The request should be filed with the district director's office that has jurisdiction over the return of the taxpayer.

William E. Williams,
Acting Commissioner of Internal Revenue.

Approved: January 13, 1981.

Donald C. Lubick,
Assistant Secretary of the Treasury.

Paragraph 1. Section 25.2514-1 is amended as follows:

(a) The last sentence of paragraph (c)(1) is revised to read as set forth below.

(b) Paragraph (d) is amended by adding four sentences after the last sentence in the paragraph to read as set forth below.

§ 25.2514-1 *Transfers under power of appointment.*

(c) *Definition of "general power of appointment."*—(1) *In general.* * * * The later power is not a general power of appointment (but its exercise may result in the exercise of the former power; see paragraph (d) of this section).

(d) *Definition of "exercise."* * * * Furthermore, if a person holds both a presently exercisable general power of appointment and a presently exercisable nongeneral power of appointment over the same property, the exercise of the nongeneral power is considered the exercise of the general power only to the extent that immediately after the exercise of the nongeneral power the amount of money or property subject to being transferred by the exercise of the general power is decreased. For example, assume A has a noncumulative annual power to withdraw the greater of \$5,000 or 5 percent of the value of a trust having a value of \$300,000 and a lifetime nongeneral power to appoint all or a portion of the trust corpus to A's child or grandchildren. If A exercises the nongeneral power by appointing \$150,000 to A's child, the exercise of the nongeneral power is treated as the exercise of the general power to the extent of \$7,500 (maximum exercise of general power before the exercise of the nongeneral power, 5% of \$300,000 or \$15,000, less maximum exercise of the general power after the exercise of the nongeneral power, 5% of \$150,000 or \$7,500).

Par. 2. Sections 25.6075 and 25.6075-1 are removed and the following new section is added in lieu thereof.

§ 25.6075-1 *Returns; time for filing gift tax returns for gifts made after December 31, 1976.*

(a) *Due date for filing quarterly gift tax returns.*—(1) Except as provided in paragraph (b) of this section, a return required to be filed under section 6019 for the first, second, or third calendar quarter of any calendar year must be filed on or before the 15th day of the second month following the close of the calendar quarter in which the taxable gift was made.

(2) If a return is required to be filed under section 6019 for the fourth calendar quarter, then—

(i) For gifts made after December 31, 1976 and before January 1, 1979, the return must be filed on or before February 15th following the close of the fourth calendar quarter, or

(ii) For gifts made on or after January 1, 1979, the return must be filed on or before April 15th following the close of the fourth calendar quarter.

(b) *Special rule.*—(1) if the total amount of taxable gifts (determined after the application of paragraph (c)(1) of this section, relating to split gifts) made by a person during a calendar quarter is \$25,000 or less, the return required under section 6019 for that quarter must be filed on or before the date prescribed in paragraph (a)(1) of this section for filing the return for gifts made in the first subsequent calendar quarter (unless the first subsequent calendar quarter is the fourth calendar quarter in which case see paragraph (b)(2) of this section) in the calendar year in which the sum of—

(i) The taxable gifts made during such subsequent calendar quarter, plus

(ii) All other taxable gifts made in prior quarters of the calendar year for which no return has yet been required to be filed,

exceeds \$25,000. The return must include transfers by gift (as required by section 6019 and the regulations under that section) made during such subsequent and prior quarters of the calendar year for which no return has yet been required to be filed and identify in which quarter such transfers were made. The return must meet all the requirements for a separate return as if a separate return had been made for each quarter in which a transfer by gift was made. This return will be treated as a separate return for each of the quarters identified on the return.

(2) If a return is not required to be filed under paragraph (b)(1) of this section, then—

(i) For gifts made after December 31, 1976 and before January 1, 1979, the return must be filed on or before February 15th following the close of the fourth calendar quarter, or

(ii) For gifts made on or after January 1, 1979, the return must be filed on or before April 15th following the close of the fourth calendar quarter.

The return must include all transfers by gift (as required under section 6019 and the regulations under that section) made during the calendar year for which no return has yet been required to be filed and identify in which quarter such transfers were made. The return must meet all the requirements for a separate return as if a separate return had been made for each quarter in which a transfer by gift was made. This return will be treated as a separate return for each of the quarters identified on the return.

(3) Under section 6075(b)(3), any extension of time granted a taxpayer for filing the return of income taxes imposed by subtitle A for any taxable year which is a calendar year shall be

treated as an extension of time granted the taxpayer for filing any return under section 6019 which is due (under paragraphs (a)(2)(ii) and (b)(2)(ii) of this section) on or before April 15th following the close of the fourth calendar quarter. See also section 6081 and § 25.6081-1 for other rules relating to extensions of time for filing returns.

(4) See section 7503 and § 301.7503-1 for the due date of a return that falls on a Saturday, Sunday, or a legal holiday. As to additions to the tax for failure to file the return within the prescribed time, see section 6651 and § 301.6651-1.

(c) *Effect of section 2513.*—(1) In determining whether taxable gifts made during any calendar quarter exceed \$25,000, and in determining whether taxable gifts made in the current calendar quarter and the preceding calendar quarters of the calendar year for which no return has yet been required to be filed exceed \$25,000, the effect of section 2513 is not taken into account for any gifts made in the current or previous quarters for which a return is now being filed unless an irrevocable consent was made by either spouse on a return that was required to be filed prior to the due date of the current return. See § 25.2513-3 for the rules relating to when a consent becomes irrevocable.

(2) Paragraph (c)(1) of this section may be illustrated by the following examples:

Example (1). During the first quarter of 1980 A made taxable gifts of \$17,000 (\$20,000—\$3,000 annual exclusion under section 2503(b)) to D. During the second quarter A made another taxable gift of \$10,000 to D. A's taxable gifts for the first two quarters are \$27,000. Therefore, A is required to file a return for the first and second quarters on or before August 15, 1980. On that return A's wife, B, consented to the application of section 2513 (relating to split gifts) for the second quarter. Even though A split the second quarter gift with his wife, A's return is nevertheless required to be filed on or before August 15, 1980 because in determining whether taxable gifts exceed \$25,000, the effect of section 2513 is only taken into account for the quarter in which an irrevocable consent was made on a return required to be filed before August 15, 1980.

Example (2). Assume the same facts as in Example (1). In addition, during the third quarter A made another taxable gift of \$20,000 to D, and B made a taxable gift of \$24,000 to D. B is required to file a return reporting the taxable gifts made during the second and third quarters on or before November 15, 1980 because B's total taxable gifts exceed \$25,000 (second quarter gifts after taking section 2513 into account = $\frac{1}{2}$ (\$10,000)—\$3,000 (annual exclusion under section 2503(b)) = \$2,000 plus a \$24,000 gift in the third quarter). Even if A and B had consented to the application of section 2513 for the third quarter, B's return would nevertheless be due on or before November

15, 1980, because an irrevocable consent was not made on a return that was required to be filed prior to November 15, 1980. However, the effect of section 2513 is taken into account for the second quarter because an irrevocable consent was made on a return that was required to be filed prior to November 15, 1980.

Example (3). During the first quarter of 1980 A made taxable gifts of \$27,000 to F (\$30,000—\$3,000 annual exclusion under section 2503(b)). A is required to file a return on or before May 15, 1980. A fails to file a return until August 1, 1980. On that return B, A's spouse, consented to the application of section 2513. The consent on that return is irrevocable under § 25.2513-3. During the second quarter B made taxable gifts of \$14,000 to F. A and B made no other gifts during 1980. B has made total taxable gifts of \$26,000 (\$12,000 for the first quarter and \$14,000 for the second quarter). Therefore, B is required to file a return on or before August 15, 1980. Even if A and B had consented to the application of section 2513 for the second quarter, B's return is nevertheless due on or before August 15, 1980. Assuming no other gifts were made during the year, A's return reporting the second quarter split gift would be due on or before April 15, 1981.

Example (4). During the first quarter of 1980 A made taxable gifts of \$20,000 to G. B, A's spouse, files a gift tax return on June 15, 1980 reporting that gift and both A and B signify their consent to the application of section 2513 on that return. In determining whether either spouse has exceeded the \$25,000 amount for the remainder of 1980, the effect of section 2513 will be taken into account for the transfer by gift made in the first quarter.

(d) *Nonresident not citizens of the United States.* In the case of a donor who is a nonresident not a citizen of the United States, paragraphs (a) and (b) of this section shall be applied by substituting "\$12,500" for "\$25,000" each place it appears. For rules relating to whether certain residents of possessions are considered nonresidents not citizens of the United States, see section 2501(c) and § 25.2501-1(d).

(e) *Effective date.* This section is effective for gifts made after December 31, 1976.

Par. 3. Section 301.6103(l)(2)-3(a) of the Regulations on Procedure and Administration is amended by revising subparagraph (23) and the flush language following subparagraph (27). These revised provisions read as follows:

§ 301.6103(l)(2)-3 Disclosure to Department of Labor and Pension Benefit Guaranty Corporation of certain returns and return information.

(a) *Disclosures following general requests.* * * *

(23) Copies of initial pleadings indicating that the Service intends to

intervene in a civil action under section 502(h) of the Act;

Return information disclosed under this paragraph includes the taxpayer identity information (as defined in section 6103(b)(6)) of the plan or trust, the name and address of the sponsor and administrator of the plan or trustee of the trust, and the name and address of the person authorized to represent the plan or trust before the Service. Disclosure of returns or return information as provided by this paragraph will be made only following receipt by the Commissioner of Internal Revenue of an annual written request for such disclosure by the Administrator of Pension and Benefit Welfare Programs of the Department of Labor or the Executive Director of the Pension Benefit Guaranty Corporation describing the categories of returns or return information to be disclosed by the Service and the particular purpose for which the returns or return information is needed in the administration of title I or IV of the Act, and designating by title the officers and employees of the Department of Labor or such corporation to whom such disclosure is authorized.

Par. 4. A new § 301.7517-1 is added to read as set forth below.

§ 301.7517-1 Furnishing on request of statement explaining estate or gift valuation.

(a) *In general.* Section 7517 requires the Service to furnish to a taxpayer, at the request of that taxpayer, a statement explaining the estate, gift or generation-skipping transfer valuation of any item contained on a return filed by the taxpayer as to which a determination or proposed determination of value has been made. The request must be filed no later than the latest time to file a claim for refund of the tax which is dependent on the value with respect to which the determination has been made. The request should be filed with the district director's office that has jurisdiction over the return of the taxpayer.

(b) *Effective date.*—(1) *Estates of decedents.* Section 7517 applies to estates of decedents dying after December 31, 1976.

(2) *Gifts.* Section 7517 applies to gifts made after December 31, 1976.

(3) *Generation-skipping transfer.* Section 7517 applies to any generation-skipping transfer subject to chapter 13.

[FR Doc. 81-2302 Filed 1-14-81; 4:48 pm]

BILLING CODE 4830-01-M

26 CFR Part 54

(T.D. 7759)

Pension Excise Taxes; Excise Taxes on Excess Contributions to Plans Covering Self-Employed Individuals

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulation.

SUMMARY: This document provides a final regulation prescribing rules for determining when there are excess contributions to "H.R. 10" or "Keogh" plans, and imposing an excise tax upon the excess, if any. Changes to the applicable tax law were made by the Employee Retirement Income Security Act of 1974 (ERISA). This regulation provides necessary guidance to the public for compliance with the law and affects all employers maintaining these plans, that is, sole proprietorships and partnerships.

DATE: The regulation is effective for employer taxable years beginning on or after January 1, 1976.

FOR FURTHER INFORMATION CONTACT: Kirk F. Maldonado of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3430) (not a toll-free number).

SUPPLEMENTARY INFORMATION:**Background**

On March 29, 1979, the Federal Register published a proposed amendment to the Pension Excise Tax Regulations (26 CFR Part 54) under section 4972 of the Internal Revenue Code of 1954 (44 FR 18700). The amendment was proposed to conform the regulations to section 2001(f)(1) of the Employee Retirement Income Security Act of 1974 (88 Stat. 955). A public hearing was neither requested nor held on this regulation. After consideration of all the comments received regarding the proposed amendment, the amendment is adopted as revised by this Treasury decision.

Applicability of Tax

Several commentators appear to have misunderstood the scope of the tax imposed by section 4972. The excise tax imposed by section 4972 applies to all excess contributions to plans benefiting self-employed individuals, regardless of whether the individual on whose behalf the contribution is made is self-employed or not. Thus, the tax applies to excess contributions made on behalf of common-law employees, if the plan

provides benefits for an individual who is or was self-employed with respect to the plan.

Correcting Distributions

Several commentators questioned whether correcting distributions made during the taxable year reduce the amount of the excess contributions for that year for purposes of computing the tax imposed by section 4972. Section 4972(b)(1) provides that the amount of the excess contributions shall be "reduced by the sum of the correcting distributions . . . made in all prior taxable years." Thus, the regulation provides that the computation of excess contributions takes into account correcting distributions made in prior taxable years, but not those made during the taxable year.

This conclusion is consistent with the legislative history of section 4972. The Conference Committee report of ERISA states:

The excess contribution may be eliminated (so as to stop the running of the tax) . . . by repayment of the excess contribution from the plan (which would reduce or eliminate the tax for subsequent years). (Emphasis added). H.R. Rep. No. 93-1280, 93d Cong., 2d Sess. 334 (1974).

Additionally, in contrast to prior law, section 4972(b)(5) does not permit, much less require, the income earned on an excess contribution to be included in a correcting distribution. Therefore, under section 4972, the income attributable to the excess contribution must remain in the plan.

Section 401(d)(4)(B) requires a plan to provide that no benefits in excess of contributions made by an owner-employee, as an employee, are to be paid to any owner-employee, except in the case of disability, prior to age 59½. This requirement only precludes a distribution to an owner-employee; it is not applicable to a correcting distribution made to the employer of the owner-employee. The proposed rule in § 54.4972-1(g)(1) has been amended to clarify that the only impermissible correcting distribution from a defined contribution plan is one made to an owner-employee prior to age 59½.

Date for Payment of the Tax

The tax imposed by section 4972 is to be paid at the time prescribed for filing Form 5330, Return of Initial Excise Taxes Related to Pension and Profit-Sharing Plans (Rev. March 1979), without regard for any filing extensions. The tax becomes due on that date so that interest will accrue on the tax between that filing date and the time the tax is actually paid.

Rollover Contributions

Several commentators have questioned whether the provisions of section 4972(c) apply to amounts contributed on behalf of owner-employees via a rollover contribution described in section 402(a)(5), 403(a)(4), 408(d)(3), or 409(b)(3)(C). Section 54.4972-1(d) has been amended to clarify that the provisions of section 4972(c) do not apply to these rollover contributions.

Drafting Information

The principal author of this regulation is Kirk F. Maldonado of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in developing these regulations, both on matters of substance and style.

Adoption of Amendment to the Regulations

Accordingly, the proposed amendment to 26 CFR Part 54 is hereby adopted, subject to the changes indicated below:

Paragraph 1. Paragraph (d) of § 54.4972-1 is revised by redesignating subparagraph (2) as subparagraph (3), and by adding a new subparagraph (2) to read as follows:

§ 54.4972-1 Tax on excess contributions to plans benefiting self-employed individuals.

(d) Contributions by owner-employees

(2) Rollover amounts. The provisions of section 4972 (c) and paragraph (d) of this section are not applicable to amounts contributed on behalf of an owner-employee in a rollover contribution described in section 402(a)(5), 403(a)(4), 408(d)(3), or 409(b)(3)(C).

Par. 2. The second to the last flush sentence of § 54.4972-1(g)(1) is revised by adding "to an owner-employee" before "prior to age 59½".

Par. 3. The first sentence of Example (i) of section 54.4972-1(g)(2) is revised by adding "who are over the age of 59½ and who are" after the words "A and B are owner-employees."

This Treasury decision is issued under the authority contained in section 7805

of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

William E. Williams,

Acting Commissioner of Internal Revenue.

Approved: January 12, 1981.

Donald C. Lubick,

Assistant Secretary of the Treasury.

Section 54.4972-1 is revised as follows:

§ 54.4972-1 Tax on excess contributions to plans benefitting self-employed individuals.

(a) *In general.* Section 4972 imposes a tax of 6 percent on the amount of the excess contributions (as defined in section 4972 (b) and (c) of this section) under certain qualified plans (as defined in paragraph (b) of this section) for each taxable year beginning after December 31, 1975, of the employer who maintains such plan. Partnerships and sole proprietors are to report this tax by filing Form 5330 (or other designated form) and the tax is to be paid annually at the time prescribed for filing such return (determined without regard to any extension of time for filing).

(b) *Employers to whom section applies.* The tax under section 4972 is imposed on employers who maintain a qualified plan during their taxable year. For this purpose, the term "qualified plan" means a pension or profit-sharing plan which includes a trust described in section 401(a), an annuity plan described in section 403(a), or a bond purchase plan described in section 405(a). In addition to being a qualified plan, the plan must provide contributions or benefits for employees some or all of whom are employees within the meaning of section 401(c)(1). For this purpose, the plan does not have to provide contributions or benefits for employees who are employees within the meaning of section 401(c)(1) during the taxable year; it is sufficient that the plan so provided in a prior taxable year.

(c) *Excess contributions—(1) In general.* For a taxable year of an employer for purposes of section 4972 and this section, the term "excess contributions" means—

(i) The amount (if any) by which the sum of—

(A) The amount (if any) determined under section 4972(b)(2) and paragraph (d) of this section, plus

(B) The amount (if any) determined under section 4972(b)(3) and paragraph (e) of this section, plus

(C) The amount (if any) determined under section 4972(b)(4) and paragraph (f) of this section, exceeds

(ii) The amount (if any) of any correcting distributions (as defined in section 4972(b)(5) and paragraph (g) of

this section) made in all prior taxable years beginning after December 31, 1975.

(2) *Contributions allocable to insurance.* For purposes of section 4972(b) and this section, the amount of any contribution made under the plan which is allocable to the purchase of life, accident, health, or other insurance is not taken into account. The amount of any contribution which is allocable to the cost of insurance protection is determined in accordance with the provisions of paragraph (g) of § 1.404(e)-1A and paragraph (b) of § 1.72-16.

(d) *Contributions by owner-employees—(1) General rule.* In the case of a plan which provides contributions or benefits for employees some or all of whom are owner-employees, within the meaning of section 401(c)(3), the amount determined under section 4972(b)(2) and this paragraph for the employer's taxable year is the amount computed separately with respect to each owner-employee equal to the sum of—

(i) The excess (if any) of

(A) The amount contributed under the plan by each owner-employee as an employee (that is, each owner-employee's contributions within the meaning of section 401(c)(5)(B)) for such taxable year of the employer, over

(B) The amount permitted under section 4972(c) and paragraph (h) of this section to be contributed by each owner-employee as an employee for such taxable year of the employer, and

(ii) The amount determined under section 4972(b)(2) and this paragraph for the immediately preceding taxable year of the employer, reduced by the excess (if any) of the amount described in subdivision (1)(B) of this subparagraph over the amount described in subdivision (1)(A) of this subparagraph for such taxable year of the employer.

(2) *Rollover amounts.* The provisions of section 4972 (c) and paragraph (d) of this section are not applicable to amounts contributed on behalf of an owner-employee in a rollover contribution described in section 402(a)(5), 403(a)(4), 408(d)(3), or 409(b)(3)(C).

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1).

(i) A and B are the only owner-employees covered under the X Employees' Trust. The X Partnership, the X Trust, and the X Plan all use the calendar year as their annual accounting period, at all relevant times. The amount determined under section 4972(b)(2) for 1975 is 0 because this section does not apply to contributions made for taxable years beginning before January 1, 1976. In calendar year 1976, A contributes \$2,500 and B contributes \$2,500 to the trust. The amount

permitted to be contributed to the trust for 1976 with respect to A as an employee is \$1,800 and with respect to B as an employee is \$2,200.

(ii) The amount determined under this paragraph for 1976 with respect to A is \$700, computed as follows: the sum of the excess of the amount contributed by A (\$2,500) over the amount permitted to be contributed by A (\$1,800), and the amount determined under this paragraph for A in 1975 (0).

(iii) The amount determined under this paragraph for 1976 with respect to B is \$300, computed as follows: the sum of the excess of the amount contributed by B (\$2,500) over the amount permitted to be contributed by B (\$2,200), and the amount determined under this paragraph for B in 1975 (0).

(iv) The amount determined under section 4972(b)(2) and this paragraph for 1976 with respect to the employer, X Partnership, is \$1,000, the sum of the amounts determined separately under this paragraph with respect to A (\$700) and B (\$300). The tax under section 4972 for 1976 on the X Partnership (assuming that no other events affecting the determination of the tax under section 4972 occur) is 6 percent of \$1,000 or \$60.

Example (2).

(i) Assume the facts stated in Example (1). In calendar year 1977, A contributes \$1,500 and B contributes \$2,300 to the trust. Assume that the amount permitted to be contributed to the trust for 1977, under section 4972(c) for A and B is \$2,500 each.

(ii) The amount determined under this paragraph for 1977 with respect to A is 0, computed as follows: the sum of 0 (the excess of the amount contributed by A (\$1,500) over the amount permitted to be contributed (\$2,500)) and \$700, the amount determined under this paragraph for A in 1976, reduced by \$1,000 (the amount permitted to be contributed by A (\$2,500) over the amount contributed by A (\$1,500)).

(iii) The amount determined under this paragraph for 1977 with respect to B is \$100, computed as follows: the sum of 0 (the excess of the amount contributed by B (\$2,300) over the amount permitted to be contributed (\$2,500)) and \$300, the amount determined under this paragraph for B in 1976, reduced by \$200 (the amount permitted to be contributed (\$2,500) by B over the amount contributed by B (\$2,300)).

(iv) The amount determined under section 4972(b) and this paragraph for 1977 with respect to the employer, X Partnership, is \$100, the sum of the amounts determined separately under this paragraph with respect to A (\$0) and B (\$100). The tax imposed under section 4972 for 1977 on the X Partnership (assuming that no other events affecting the determination of the tax under section 4972 occur) is 6 percent of \$100, or \$6.

(e) *Defined benefit plans—(1) General rule.* In the case of a defined benefit plan (as defined in section 414(j)), the amount determined under section 4972(b)(3) and this paragraph for the taxable year of the employer is the amount contributed under the plan by the employer during the taxable year plus the amounts, if any, contributed by the employer during any prior taxable

year beginning after December 31, 1975, if—

(i) As of the close of the taxable year, the full funding limitation of the plan (determined under section 412(c)(7) and the regulations thereunder) is zero, and

(ii) Such amounts contributed have not been deductible by the employer for the taxable year or for any prior taxable year beginning after December 31, 1975. See section 404 and the regulations thereunder for the determination of the amount deductible by the employer for the taxable year. If the amounts contributed by the employer exceed the amounts which have been deductible, the amount determined under this paragraph shall not exceed the amounts which have not been deductible. For purposes of this paragraph, the determination of both the amounts contributed and the amounts deductible by the employer for any relevant taxable year includes amounts contributed and deductible on behalf of any employee covered under the plan, including common-law employees and other self-employed individuals who are not owner-employees in addition to owner-employees. The determination of whether the full funding limitation is zero shall be made taking into account all the plan assets unreduced by any deduction carryover under section 404(a)(1)(D). The determination of whether the full funding limitation is zero as of the close of the employer's taxable year shall be made with respect to the plan year ending with or within the employer's taxable year.

Consequently, if an employer whose taxable year is the calendar year establishes and maintains a defined benefit plan whose plan year begins on July 1 and ends on June 30, the full funding limitation for that plan will be determined with respect to the plan year ending on June 30 within the calendar taxable year including that June 30.

(2) *Illustration.* The provisions of this paragraph may be illustrated by the following example:

Example. (i) X Partnership ("X") adopts the Y Defined Benefit Plan ("Y Plan") on January 1, 1977. The taxable year of X is the calendar year. The Y Plan also has a calendar plan year. For 1977, \$25,000 is contributed to the Y Plan by X. Assume that for 1977, (1) only \$10,000 is deductible by X for 1977 under section 404 and (2) the full funding limitation of the Y Plan (determined under section 412(c)(7)) on December 31, 1977, is greater than zero. For 1978, X makes no additional contributions to the Y Plan. Assume that for 1978, (1) no amount is deductible by X under section 404 and (2) the full funding limitation of the Y Plan (determined under section 412(c)(7)) on December 31, 1978, is zero. The amount determined under section 4972(b)(3) and this paragraph for the 1978 taxable year

is \$15,000, computed as follows: the difference between (A) the sum of the amounts contributed by X for taxable year 1978 (0), and the amounts contributed by X for taxable year 1977 (\$25,000) and (B) the sum of the amount deductible for taxable year 1978 (0) and the amount deductible for taxable year 1977 (\$10,000). The tax imposed under section 4972 for 1978 on X (assuming that no other events affecting the determination of the tax under section 4972 occur) is 6 percent of \$15,000 or \$900.

(ii) For 1979, X makes no additional contributions to the Y Plan. Assume that for 1979, (1) the full funding limitation of the Y Plan determined under section 412(c)(7) is greater than zero. Assume further that \$10,000 of the amounts contributed for 1977 is deductible by X for 1979 under section 404. There is no amount determined under section 4972(b)(3) and this paragraph for 1979 because the condition described in subparagraph (1)(i) of this paragraph is not satisfied.

(iii) For 1980, X makes no additional contributions to the Y Plan. Assume that for 1980, (1) no amount is deductible under section 404 and (2) the full funding limitation of the Y Plan (determined under section 412(c)(7)) on December 31, 1980, is zero. The amount determined under section 4972(b)(3) and this paragraph for the 1980 taxable year is \$5,000, computed as follows: the difference between (A) \$25,000, the sum of the amounts contributed by X for taxable years 1980 (0), 1979 (0), 1978 (0), and 1977 (\$25,000) and (B) \$20,000, the sum of the amounts deductible for taxable years 1980 (0), 1979 (\$10,000), 1978 (0), and 1977 (\$10,000). The tax imposed under section 4972 for 1980 on X (assuming that no other events affecting the determination of the tax under section 4972 occur) is 6 percent of \$5,000, or \$300.

(f) *Defined contribution plans—(1) General rule.* In the case of a defined contribution plan (as defined in section 414(i)), the amount determined under section 4972(b)(4) and this paragraph for the taxable year of the employer is equal to the portion of the amounts contributed under the plan by the employer during the taxable year plus the amounts contributed by the employer during any prior taxable year beginning after December 31, 1975, which has not been deductible by the employer for the taxable year or for any such prior taxable year. For purposes of this paragraph, the determination of both the amounts contributed and the amounts deductible by the employer for any relevant taxable year includes amounts contributed and deductible on behalf of any employee covered under the plan, including common-law employees and other self-employed individuals who are not owner-employees in addition to owner-employees.

(2) *Illustration.* The provisions of this paragraph may be illustrated by the following example:

Example. (i) The X Partnership ("X") adopts the Z Defined Contribution Plan and Trust ("Z Plan") on January 1, 1976. X's taxable year and the plan year of Z Plan are both calendar years. For 1976, X contributes \$40,000, of which \$30,000 is deductible under section 404 for taxable year 1976. The amount determined under section 4972(b)(4) and this paragraph for 1976 is \$10,000 (the difference between (A) \$40,000, the amount contributed by X for taxable year 1976 and (B) \$30,000, the amount deductible for taxable year 1976).

(ii) For 1977, X contributes \$25,000, and the amounts deductible by X under section 404 for taxable year 1977 is \$30,000 (\$5,000 for the contribution carryover from 1976 and \$25,000 with respect to the 1977 contribution). The amount determined under section 4972(b)(4) and this paragraph for 1977 is \$5,000, computed as follows: the difference between (A) \$65,000, the sum of the amounts contributed by X for taxable year 1976 (\$40,000) and the amounts contributed by X for taxable year 1977 (\$25,000), and (B) \$60,000, the sum of the amounts deductible for taxable year 1976 (\$30,000) and the amounts deductible for taxable year 1977 (\$30,000).

(g) *Correcting distribution—(1) General rule.* For purposes of section 4972(b) and this paragraph, the term "correcting distribution" means, for the taxable year of the employer, the sum of—

(i) In the case of a contribution made as an employee by an owner-employee, within the meaning of section 401(c)(3), to a defined benefit or defined contribution plan, the amount, or any part thereof, determined under section 4972(b)(2) and paragraph (d) of this section which is distributed to the owner-employee who contributed such amount to the plan;

(ii) In the case of a defined benefit plan, the amount, or any part thereof, determined under section 4972(b)(3) and paragraph (e) of this section which is distributed from the plan to the employer, and

(iii) In the case of a defined contribution plan, the amount, or any part thereof, determined under section 4972(b)(4) and paragraph (f) of this section which is distributed to (A) the employer or (B) to the employee for whom such amount was contributed. If, for any employer taxable year in which a defined contribution plan is maintained, there is a correcting distribution to an employee which could be from amounts described in subparagraph (1)(i) and (iii) of this paragraph for such employee, then such correcting distribution shall be deemed to be made first from amounts described in such subparagraph (1)(i) and then from amounts described in such subparagraph (1)(iii) for purposes of this section and section 72. For the income tax treatment of such distributions to

employees, see section 72 and the regulations thereunder. Any such distributions to employees shall not be subject to the tax imposed by section 4975 nor result in the defined contribution plan failing to satisfy the exclusive benefit requirement of section 401(a), solely by reason of being a correcting distribution within the meaning of this paragraph. If, for any employer taxable year in which a defined benefit, or defined contribution plan is maintained, there is a correcting distribution described in subparagraph (1)(ii) or (iii) of this paragraph to the employer maintaining the plan, such distribution shall not be subject to the tax imposed by section 4975 nor result in the plan's failing to satisfy the exclusive benefit or the definitely determinable requirements under section 401(a). If, for any employer taxable year in which a money purchase pension plan is maintained, a correcting distribution described in subparagraph (1)(iii) of this paragraph is made to an employee who has not yet become eligible to receive retirement benefits under the plan, the qualification of the pension plan (and trust) under section 401(a) may be adversely affected. See § 1.401-1(b)(1)(i). A correcting distribution described in subparagraph (1)(iii) of this paragraph to an owner-employee prior to age 59½ must be precluded under the plan. See section 401(d)(4)(B).

(2) *Illustration.* The provisions of this paragraph may be illustrated by the following example:

Example. (i) A and B are owner-employees who are over the age of 59½ and who are covered under the X Employees' Defined Contribution Plan and Profit-Sharing Trust ("Plan Y"). The X Partnership ("X") and Plan Y are on calendar years. In calendar year 1976, A contributes \$2,500 and B contributes \$2,500 to Plan Y. The amount permitted to be contributed to Plan Y for 1976 with respect to A as an employee is \$1,800 and with respect to B as an employee is \$2,200. X contributes to Plan Y \$5,000 on behalf of A and \$5,000 on behalf of B. Of this amount, assume that \$2,700 is deductible with respect to A and \$3,300 is deductible with respect to B by X under section 404. The amount determined under section 4972(b)(2) and paragraph (d) of this section (the excess owner-employee contributions made by A and B to Plan Y) for taxable year 1976 is \$1,000, computed as follows: the sum of (A) for A, \$700, the difference between his own contributions (\$2,500) and the amount permitted to be contributed by A (\$1,800) and (B) for B, \$300, the difference between his own contributions (\$2,500) and the amount permitted to be contributed by B (\$2,200). The amount determined under section 4972(b)(4) and paragraph (f) of this section (the excess contributions made by X to Plan Y) for taxable year 1976 is \$4,000, computed as follows: the sum of (A) by X for A, \$2,300, the

difference between contributions by X (\$5,000) and the amount deductible by X for A (\$2,700) and (B) by X for B, \$1,700, the difference between contributions by X for B (\$5,000) and the amount deductible by X for B (\$3,300). During 1976, there is no correcting distribution, within the meaning of section 4972 and this paragraph, because there are no distributions to A, B, or X.

(ii) Assume that, for taxable year 1977, the amounts determined under sections 4972(b)(2) and 4972(b)(4) remain the same as for taxable year 1976, that is, \$1,000 (\$700 for A and \$300 for B) and \$4,000 (\$2,300 by X for A and \$1,700 by X for B), respectively. Assume further that, in 1977, Plan Y distributes \$3,000 to A and \$1,000 to B. The amount determined under section 4972(b)(5) and this paragraph (the correcting distribution for Plan Y) for taxable year 1977 is \$4,000, computed and attributed as follows: the sum of (A) \$3,000 with respect to A, the amount of the distribution to A applied first to A's \$700 amount described in subparagraph (1)(i) of this paragraph and next to A's \$2,300 amount described in subparagraph (1)(iii) of this paragraph and (B) \$1,000 with respect to B, the amount of the distribution to B applied first to B's \$300 amount described in subparagraph (1)(i) of this paragraph and next to B's \$1,700 amount described in subparagraph (1)(iii) of this paragraph. For purposes of computing the excess contributions for taxable year 1977, the correcting distribution of \$4,000 would not be taken into account because only correcting distributions for prior year are considered. However, for taxable year 1978 the correcting distribution of \$4,000 would be taken into account.

(iii) Assume that, for taxable year 1978, there are no additional amounts determined under sections 4972(b)(2) and 4972(b)(4) and that Plan Y distributes \$900 to B. The amount determined under section 4972(b)(5) and this paragraph (the correcting distribution for Plan Y) for the 1978 taxable year is \$900, computed and attributed as follows: the amount of the distribution to B, \$900, applied to B's \$1,000 amount described in subparagraph (1)(iii) of this paragraph. For purposes of computing the excess contributions for taxable year 1978, the correcting distribution of \$900 would not be taken into account. However, for taxable year 1979, the correcting distribution of \$900 would be taken into account.

(h) *Amount permitted to be contributed by owner-employee—(1) General rule.* Except as provided in subparagraph (2), for purposes of section 4972(b)(2) and paragraph (d), the amount permitted to be contributed under a plan by an owner-employee as an employee for any taxable year of the employer is the smallest of the following—

- (i) \$2,500;
- (ii) 10 percent of the earned income (as defined in section 401(c)(2)) for such taxable year derived by the owner-employee from the trade or business with respect to which the plan is established, or

(iii) The amount of the contribution which would be contributed by the owner-employee (as an employee) if such contribution were made at the rate of contributions which is permitted to be made by employees who are not owner-employees during such taxable year.

(2) *Special rule.* In the case of a taxable year of the employer in which there are no employees other than owner-employees, the amount permitted to be contributed under a plan by an owner-employee (as an employee) is zero.

(i) *Special rules and cross references—(1) Time of contributions.* For purposes of this section, time of employer contributions made with respect to any taxable year shall take into account the rules specified in section 404(a)(6), relating to time when contributions deemed made.

(2) *Disallowance of deduction.* For disallowance of deduction for taxes paid under this section, see section 275(a)(6).

(3) *Certain annuity contracts.* For a special rule relating to owner-employee contributions for premiums on annuity, etc. contracts, see § 1.401(e)(4)(a).

(4) *Disqualification for excess contributions.* For plan qualification requirements relating to excess contributions, see section 401(d)(5).

[FR Doc. 81-2303 Filed 1-16-81—4:51 pm]
BILLING CODE 4830-01-M

DEPARTMENT OF COMMERCE

Patent and Trademark Office

37 CFR Part 2

Trademark Opposition and Cancellation Proceedings: Compulsory Counterclaims

AGENCY: Patent and Trademark Office (PTO), Department of Commerce.

ACTION: Final rule.

SUMMARY: This amendment of the rules of practice in trademark cases provides explicitly for compulsory counterclaims under stated conditions in opposition and cancellation proceedings before the Trademark Trial and Appeal Board in the Patent and Trademark Office. The amendment establishes the authority for a pre-existing practice which has been held on judicial review to be unauthorized by the existing rules.

EFFECTIVE DATE: April 1, 1981.

FOR FURTHER INFORMATION CONTACT: David J. Kera, Member, Trademark Trial and Appeal Board, Commissioner of Patents and Trademarks, Washington, D.C. 20231. 703-557-3551.

SUPPLEMENTARY INFORMATION: On April 16, 1979 notice was given in the Federal Register (44 FR 22478) of a proposal to amend two sections of Title 37 of the Code of Federal Regulations relating to trademark opposition and cancellation proceedings. Interested persons were invited to comment on the proposal by May 15, 1979. Twenty-six written letters and statements were submitted. Careful consideration has been given to all comments received, and the proposal is being adopted with certain changes.

The regulations adopted involve both sections that were proposed to be revised, amended or added—namely, §§ 2.106 and 2.114.

This amendment has been reviewed pursuant to Executive Order 12044 and found to have no major economic consequences and therefore does not require a regulatory analysis.

The text of the rules will be reproduced in the Patent and Trademark Office Official Gazette in about two months with additions indicated by arrows and deletions indicated by brackets to help readers identify the changes. The letters and written statements received and a summary and analysis of the comments are available for public inspection in Room 11E10, Crystal Plaza, Building 3, 2021 Jefferson Davis Highway, Arlington, Virginia.

Purpose of Rules

The purpose of the rules that are being adopted is to make it compulsory for a defendant to file a counterclaim for the cancellation of the registration pleaded by the plaintiff in an opposition or cancellation proceeding if the defendant wants to challenge the validity of the plaintiff's registration and if the grounds for a counterclaim exist when the answer to the notice of opposition or petition for cancellation is filed. When a defendant in an opposition or cancellation proceeding desires to eliminate the plaintiff's registration as a ground upon which the opposition or cancellation is based, a petition by the defendant to cancel the plaintiff's registration is mandatory because the validity of the plaintiff's registration cannot be questioned so long as it remains uncanceled.¹

The effect of the rules is that if a counterclaim is not filed as provided by the rules, the applicant or respondent will thereafter be barred from seeking to cancel the registration pleaded by the opposer or cancellation petitioner in the prior proceeding on any ground which existed at the time when the answer was filed.

The rules that are being adopted avoid piecemeal litigation of a multiplicity of actions and counteractions relating to a single conflict or controversy. For instance, when the issue is likelihood of confusion and a question is raised whether the plaintiff's registration should remain on the register or should be cancelled, that question must be decided before there can be a determination of the issue whether the defendant's mark involved in an opposition proceeding should be registered or whether the defendant's registration involved in a cancellation proceeding should be cancelled.² To permit a defendant to litigate a first case to a decision, which by hypothesis the plaintiff would win, and thereafter permit the defendant to petition for the cancellation of the plaintiff's registration, would allow a proliferation of proceedings and would meanwhile result in the first plaintiff's registration remaining on the register when it might be an improper registration. If the party which was the defendant in the first case should win the second case and thereafter file a new application to register its mark, there would have been a substantial period of time when the register would not have reflected the true rights of the parties. This situation would be detrimental to the public, which searches the register and relies upon the rights recorded there when deciding upon the availability of new marks for adoption and use.³ Since a claim of invalidity of a registration of a mark is logically related to the issue of enforceability of the registration in an opposition or cancellation proceeding, the consolidation in one proceeding of all claims determinable by the Patent and Trademark Office arising out of a particular conflict will avoid unnecessary delays and unnecessary proliferation of proceedings to decide what is a single controversy. By adopting the rules, the Office is taking steps to have the pleadings of the

parties present the entire controversy at one time and to have discovery, trial, final briefs and oral argument in one proceeding instead of several. Both the parties and the public will benefit from the more efficient procedure established by the rules being adopted.

Compulsory Counterclaims

Amended §§ 2.106(b) and 2.114(b) provide that an answer may contain any defense, including the affirmative defenses of unclean hands, laches, estoppel, acquiescence, fraud, mistake or prior judgment. When pleading special matters, the Federal Rules of Civil Procedure are to be followed. A reply to an affirmative defense need not be filed. However, a defense attacking the validity of any one or more of the registrations pleaded in the opposition or petition for cancellation is a compulsory counterclaim if grounds for such counterclaim exist at the time when the answer is filed. If grounds for a counterclaim are known to the applicant or respondent when the answer to the opposition or petition is filed, the counterclaim must be pleaded with or as part of the answer. If grounds for a counterclaim are learned during the course of the opposition or cancellation proceeding, the counterclaim must be pleaded promptly after the grounds therefor are learned. A counterclaim need not be filed, however, if it is the subject of another proceeding between the same parties or anyone in privity therewith.

Amended §§ 2.106(b) and 2.114(b) further provide that an attack on the validity of a registration pleaded by an opposer or petitioner will not be heard unless a counterclaim or separate proceeding is filed to seek the cancellation of such registration. A pleaded registration is a registration identified by number and date of issuance in an original notice of opposition or petition for cancellation, or in any amendment thereto made under Rule 15, FRCP. The provisions of §§ 2.111 through 2.115, inclusive, are applicable to counterclaims and a time, not less than thirty days, will be designated within which an answer to a counterclaim must be filed. Upon motion by a party, the times for pleading, discovery, testimony, briefs or oral argument will be reset or extended when necessary to enable a party fully to present or meet a counterclaim or separate petition for cancellation of a registration.

In response to some of the comments, §§ 2.106(b)(1) and 2.114(b)(1) have been changed by the inclusion of a sentence to make it clear that they are applicable only when a pleaded registration is

¹ See *King Candy Co. v. Eunice King's Kitchen, Inc.*, 182 USPQ 106 (CCPA 1974), where the Court held that the registered mark of even a subsequent-user opposer must be considered in an opposition; cf. *Morehouse Mfg. Corp. v. J. Strickland & Co.*, 100 USPQ 715 (CCPA 1969), where, in an analogous situation, the Court said that the Board had taken the proper approach in first determining a cancellation petition by the plaintiff against the defendant's existing registration and then, after dismissing petition for cancellation, dismissed the opposition by the plaintiff against an application by the defendant for the registration of substantially the same mark for the same goods. The Court indicated that the issues in the cancellation had to be decided first because they were controlling.

² The public has an interest in the removal from the register of improvidently issued registrations. *Seifway, Inc. v. Travelers Petroleum, Inc.*, 198 USPQ 271 (CCPA, 1976).

³ See *Contour Chair-Lounge Co., Inc. v. The Englander Co., Inc.*, 139 USPQ 285 (CCPA 1963).

identified by number and date of issuance in an original or amended notice of opposition or petition for cancellation. Since a party may not rely on a proceeding being prosecuted by a stranger, §§ 2.106(b)(2)(i) and 2.114(b)(2)(i) have been modified from the version published for comment so as to state explicitly that the separate proceeding for the cancellation of an opposer's or cancellation petitioner's registration which would obviate the need for a counterclaim must be between the same parties or anyone in privity therewith. It should be noted that the Trademark Trial and Appeal Board has control over its docket so that a case may be suspended at the request of a party when a separate proceeding in a more advanced stage may render a case moot, thereby avoiding unnecessary litigation.

Two comments stated that there is no basis in the Trademark Act for the compulsory counterclaim rules in amended §§ 2.106(b)(2) and 2.114(b)(2). Several related comments were to the effect that these sections would operate to bar a claim against a plaintiff's registration prior to the time when such a claim would be barred by section 14 of the Act.

Initially, it should be noted that the presence of Rule 13(a) in the Federal Rules of Civil Procedure shows that there is no constitutional impediment to a compulsory counterclaim rule of procedure. Moreover, it is considered to be within the power of the Commissioner of Patents and Trademarks to adopt compulsory counterclaim rules, which are not inconsistent with any provision of the Trademark Act, as part of the rules and regulations for the conduct of proceedings in the Patent and Trademark Office, as authorized by section 41 of the Trademark Act.

Courts have long recognized that a compulsory counterclaim rule operates to compel a party to raise a claim at a time chosen by its opponent.⁴ This necessarily means that a party may be compelled to raise a claim, or to lose it, long prior to the time when a statute of limitations would absolutely bar the claim. Sections 14 (a) and (b) of the Trademark Act have been interpreted as a statute of limitations barring claims against certain registrations on particular grounds more than five years after a specified event (the issuance or republication of a registration under the Trademark Act of 1946) has occurred.⁵

As there is nothing inconsistent between a statute of limitations and a compulsory counterclaim rule, so there is nothing inconsistent between a statutory cause of action for which there is no statute of limitations (sections 14 (c), (d), and (e) of the Trademark Act) and a compulsory counterclaim rule insofar as there is a particular controversy involving particular marks and specified goods or services. The effect of amended §§ 2.106(b) and 2.114(b) is simply to require the timely assertion of a claim, if one exists, under sections 14 (c), (d), and (e) of the Trademark Act. If a plaintiff's registration is invalid, it is to the benefit of the public as well as to the defendant to have it promptly removed from the register, and it is to the advantage of the parties and the board to have the issue litigated in one case rather than in a protracted series of cases. Since there is no provision of the Trademark Act with which the compulsory counterclaim rules are inconsistent and the rules are for the conduct of proceedings under the Trademark Act, it is concluded that the Commissioner possesses the statutory authority under section 41 of the Trademark Act to adopt the rules.

Although one comment stated that amended §§ 2.106(b)(2)(i) and 2.114(b)(2)(i) are broader than the compulsory counterclaim rule of Rule 13(a), FRCP, it is the position of the Patent and Trademark Office that amended §§ 2.106(b)(2)(i) and 2.114(b)(2)(i) comport with the practice on compulsory counterclaims announced and followed by the Federal Courts in applying Rule 13(a), FRCP.⁶ Assuming that the comment is meant to point out that the plaintiff's right to prevent or cancel a registration and the defendant's right to obtain or retain a registration do not arise out of the "transaction or occurrence that is the subject matter of the opposing party's claim" (the language in Rule 13(a), FRCP), the answer is that an inter partes proceeding before the Board is *sui generis* and the continued existence or not of the plaintiff's registration is inextricably involved in the determination of the defendant's right to obtain or to maintain a registration when the issue is likelihood of confusion.

The occasion for a counterclaim will typically arise in practice only when an opposer or a cancellation petitioner

seeks to prevent or to cancel a registration of an applicant or a respondent on the ground that the defendant's mark is likely to cause confusion or mistake or to deceive within the meaning of section 2(d) of the Trademark Act. Certainly the defense that a registration pleaded by an opposer or cancellation petitioner is invalid and therefore cannot support the pleaded claim of damage is, at the very least, an offshoot of the same basic controversy between the parties and is the essence of an affirmative defense. By virtue of section 2(d), the plaintiff's registration and the defendant's entitlement to a registration are parts of the same transaction, i.e., the process of deciding whether the defendant has a right to obtain or retain a registration.⁷

The same analysis responds to the five comments that the first action and a counterclaim are not intimately related or do not arise out of the same factual situation. A pleaded registration is a substantive part of the evidentiary case on behalf of an opposer or cancellation petitioner who is prosecuting a proceeding based upon likelihood of confusion since, in an opposition, it must be considered regardless of the parties' dates of use and, in a cancellation, is evidence of continuous use since the filing date of the application which issued into the registration. An attack on the validity of the pleaded registration, which must be by means of a counterclaim or petition for cancellation, is thus a related branch of the same basic controversy, and, as such, it is properly a compulsory counterclaim. Furthermore, if the counterclaim or petition for cancellation is premised on allegations of likelihood of confusion and priority of use, as is often the situation, the same factual and legal issues are present in both the opposer's or cancellation petitioner's case and the applicant's or respondent's case; *a fortiori*, a counterclaim is properly compulsory. To argue from a defendant's side that it is involuntarily involved does not justify not having to prosecute a counterclaim if grounds for it exist. A person accused of trademark infringement in an action in a District Court is just as involuntarily involved and it would be anomalous if a claim against the plaintiff's registration in such a proceeding were not considered a compulsory counterclaim.

What has been said above answers the comment that there is no judicial economy in a compulsory counterclaim rule. Without such a rule the following

⁴ See *Martino's v. McDonald's System, Inc.*, 27 FR Serv 2d 501 (7th Cir. 1979).

⁵ See *National Service Industries, Inc. v. Turtle Wax, Inc.*, 154 USPQ 68 (TTAB 1967).

⁶ See *Martino's v. McDonald's System, Inc.*, supra, n. 4; *Plant v. Blazer Financial Services Inc. of Georgia*, 27 FR Serv 2d 955 (5th Cir. 1979); *Irrigation & Power Equipment, Inc. v. Machinery Specialties Pty., Ltd.*, 202 USPQ 12 (D. Colo. 1977); and *Lewis Manufacturing Co., Inc. v. Chisholm-Ryder Co., Inc.*, 27 FR Serv 2d 1166 (D. Pa. 1979).

⁷ See *Webster's New Collegiate Dictionary* (1977) at 1239, which defines "transaction" as "an act, process or instance of transacting."

sequence of events could take place. An opposer could rely on a registration; the applicant could take no testimony; and the opposition would be decided in favor of the opposer. The applicant could then petition for cancellation of the opposer's registration on the ground of prior use. A defense of collateral estoppel raised by the initial opposer on the issue of priority would be met by the applicant with the argument that proof of priority of use in the opposition would have been irrelevant, citing *King Candy Co. v. Eunice King's Kitchen, Inc.*, supra, n. 2, and therefore was not necessary to the determination of the opposition. A second proceeding would thus be litigated. Assuming applicant prevailed, presumably a second application would be filed. Thus the Office would have had to deal with two contested proceedings and two applications to determine rights that could have been ascertained on the basis of one application and one proceeding. An opposer which thought it had prevailed would discover that it had won a Pyrrhic—even a phantom—victory, and the register would have incorrectly reflected the rights of the parties, to the detriment of the public, for an extended period of time. To contend, in these circumstances, that the rule would not result in judicial, examining and public economy is to miss the point entirely.

Several comments stated that even under amended §§ 2.106(b) and 2.114(b), the Board cannot settle all of the potential issues between the parties because matters of infringement and unfair competition are for the courts to decide. It should be pointed out that the rules being adopted are designed to settle in one proceeding all of the issues determinable within the Patent and Trademark Office, arising from a particularized controversy involving specified marks and goods or services, which are ripe for litigation and adjudication. Obviously, issues outside the jurisdiction of the Board cannot be determined.

Amended §§ 2.106(b) and 2.114(b) do not impose a new and untried practice on the Trademark Trial and Appeal Board. On the contrary, a compulsory counterclaim rule was in effect and worked well from the date of the decision in *Outdoor Sports Industries, Inc. v. The Joseph & Feiss Co.*, 177 USPQ 535 (TTAB 1973), petition denied, 177 USPQ 533 (Comm'r. Pats 1973) to the date of the decision in *Endo Laboratories, Inc. v. Fredericks*, 197 USPQ 560 (TTAB 1977).^{*} No objection to

the practice from any source came to the Board's attention and no appeal from a decision applying the practice was prosecuted to an appellate decision except for *Thuron Industries, Inc. v. The Conrad-Pyle Co.*, 198 USPQ 403 (CCPA 1978), where the Court held that Rule 13(a), FRCP, did not support the Board's practice and that § 2.106(b), as then written, was a permissive rather than a mandatory rule. Nevertheless, during the five-year period in which a compulsory counterclaim practice was in effect, the Board did not experience any undue difficulty in discovery or motion practice, did not observe any unusual increase in the number of counterclaims that were filed and did not find that proceedings were made longer or more complicated by reason of the counterclaim practice. On the contrary, the Board's experience showed that the compulsory counterclaim practice resulted in a net saving of time and resources, thereby enabling the Board to function more efficiently and to serve the public interest more effectively.

Several comments stated that the compulsory counterclaim rules will provoke unnecessary conflicts or will make settlements more difficult to achieve. It is considered very unlikely that provisions for compulsory counterclaims will stimulate needless conflicts (by definition, a conflict exists before a counterclaim would be filed) or hamper attempts to reach a settlement. When parties have conflicting claims against each other, it is believed that both would have reason to explore the possibility of an amicable settlement which would obviate the need for litigation. However, in response to a suggestion received, it is considered inadvisable to quote or refer to the compulsory counterclaim rules in the Office letter notifying an applicant of an opposition or a respondent of a cancellation proceeding because that might be misinterpreted as a direction to file a counterclaim in every proceeding.

A few comments questioned the effect of amended §§ 2.106(b) and 2.114(b) on subsequent court litigation between the parties. These sections apply only to proceedings before the Trademark Trial and Appeal Board; they do not and could not affect the powers over registrations conferred upon the Federal Courts by section 37 of the Trademark Act. The Patent and Trademark Office cannot, of course, speculate on how courts may apply the doctrine of

estoppel to claims which might have been, but were not, litigated in the Office. This and other questions remain to be answered by the evolution of case law after the amended rules become effective.

It is expected that in the original notice of opposition or petition for cancellation, an opposer or cancellation petitioner will identify by number and date of issuance each registration upon which it expects to rely. The deliberate withholding, until the testimony period of an opposer or cancellation petitioner, of the identification of the registration or registrations intended to be introduced in evidence in support of the claim of damage causes unwarranted surprise and prejudice to an applicant or respondent. Such a practice frustrates proper discovery and preparation for trial. The burden is upon an opposer or cancellation petitioner to present initially a pleading that gives fair notice of the case that an applicant or respondent must meet. The Federal Rules of Civil Procedure reject the approach that pleading is a game of skill.^{*}

The Patent and Trademark Office recognizes that situations will arise where an opposer or cancellation petitioner will want to introduce a registration which was not originally pleaded. This may be done by a motion to amend the pleadings under Rule 15, FRCP, to add one or more registrations. When they are pleaded by number and date of issuance, amended §§ 2.106(b) and 2.114(b) will then apply to any added registration. It should be remembered that a long and unexplained delay in the filing of a motion to amend a notice of opposition or petition for cancellation, when there is no question of newly discovered evidence (as there would not be when a party is pleading its own registration), may render the amendment untimely if the defendant is thereby prejudiced.¹⁰ It therefore behooves an opposer or cancellation petitioner to plead its registration by number and date of issuance, if not in the original notice of opposition or petition for cancellation, as soon as possible after the omission (or newly issued registration) comes to the opposer's or cancellation petitioner's attention. Amended §§ 2.106(b)(2)(iv) and 2.114(b)(2)(iv) provide sufficient flexibility to allow an applicant or respondent fair and adequate opportunity to plead, take discovery, and present evidence on a counterclaim

(TTAB 1973); *Kajita v. Walter Kidde & Co.*, 185 USPQ 436 (TTAB 1975); *Delta Tire Corp. v. Sports Car Club of America, Inc.*, 185 USPQ 443 (TTAB 1975); and *Scovill Mfg. Co. v. Stocko Metallwarenfabriken Henkels und Sohn KG*, 188 USPQ 24 (TTAB 1975).

^{*}During this period, the following cases applied the compulsory counterclaim rule then in effect: *Tetron, Inc. v. The Gillette Co.*, 180 USPQ 152

^{*}See *Tiffany & Co. v. Columbia Industries, Inc.*, 173 USPQ 6 (CCPA 1972).

¹⁰See *Ercona Corp. v. JENAer Glaswerk Schott & Gen.*, 182 USPQ 573 (TTAB 1974).

on any available ground when an opposer or cancellation petitioner pleads a registration in an amended notice of opposition or petition for cancellation.

An opposer or cancellation petitioner may withdraw without prejudice a notice of opposition or a petition for cancellation before an answer is filed. See §§ 2.106(c) and 2.114(c). One comment inquired what would happen if the defendant failed to file an answer. When an applicant or respondent elects not to answer, the opposition or cancellation is decided as in a case of default. See §§ 2.106(a) and 2.114(a). If no answer of any kind is filed, there can be no counterclaim, which is, by definition, a pleading within an answer. If a party is willing to lose by default, there is a very high probability that there is no interest in the mark, at least for the goods or services identified in the application being opposed or in the registration sought to be cancelled.

One comment expressed concern that the premature destruction of the records of proceedings in the Patent and Trademark Office might impede or prevent a party from rebutting a contention that a compulsory counterclaim was not filed. There should be no apprehension that the destruction or loss of Office records would interfere with a just application of amended §§ 2.106(b) and 2.114(b). Every paper in every proceeding is either filed by or served upon every party. See §§ 2.105, 2.113 and 2.119(a). In every case, the decision or an order terminating the proceeding is served on every party through counsel or directly when there is no counsel. Thus, every party to a proceeding will have a complete record of the pleadings and the decision or order terminating a proceeding for future use as needed.

Several comments raised the question of the effect of amended §§ 2.106(b)(2)(i) and 2.114(b)(2)(i) in situations where the grounds for a counterclaim exist but are not known to a defendant. Several related comments indicated a lack of understanding of the difference between the existence of grounds for a counterclaim and knowledge of those grounds by a defendant. One comment stated that the author agreed with the proposed rules if they were limited to grounds the defendant knew or had reason to know, and one comment stated that the proposed rules should limit compulsory counterclaims to certain causes of action, e.g., likelihood of confusion combined with priority of use. Another comment was in favor of the adoption of the proposed rules

provided that a counterclaim could be pleaded in an amended answer.

A distinction is made in amended §§ 2.106(b)(2)(i) and 2.114(b)(2)(i) between the time when a cause of action giving rise to a counterclaim must have matured for a counterclaim to be compulsory and the time when the counterclaim be pleaded. The cause of action must have matured by the date of filing of the answer to the notice of opposition or petition for cancellation in order for the counterclaim to be compulsory in that proceeding. Rule 13(a), FRCP, provides that "A pleading shall state as a counterclaim any claim which at the time of serving the pleading the pleader has against any opposing party * * *" (emphasis added). This indicates that there should be a date which sets a limit so that if a claim matures thereafter it is not a compulsory counterclaim. The date of filing of the answer seems to be, in the context of proceedings before the Board, a fair limiting date. Thus, if a cause of action, such as abandonment,¹¹ does not exist until after the date of the answer, it is not a compulsory counterclaim. That is, if the cause of action for the cancellation of the plaintiff's pleaded registration has not matured by the date of filing of the answer, the filing of a counterclaim is permissive rather than mandatory.

It is recognized that the grounds for a counterclaim may remain unknown until after the initial answer is filed. In certain situations the defendant will usually know the grounds, or at least have knowledge upon which a counterclaim could be pleaded in good faith on information and belief, before the answer is filed. These grounds include likelihood of confusion combined with priority of use, or mere descriptiveness of the plaintiff's alleged mark, or that the plaintiff's alleged mark is the common descriptive name of a product or service. In other situations, the grounds for a counterclaim may be learned by means of discovery or, in some instances, as a result of an opposer's or cancellation petitioner's evidence. Examples of such grounds are abandonment and, rarely, fraud. In the absence of a separate petition for cancellation previously filed by a party or anyone in privity therewith, the counterclaim must be filed as part of the answer (which means that the answer must be verified and the proper cancellation fee paid) if the grounds are known when the answer is filed. If grounds for cancellation are learned

after the answer is filed, the counterclaim must be filed promptly (which is a flexible standard) after the grounds are learned if it is to be asserted. The counterclaim which is added by an amendment to the answer must be verified and accompanied by the proper fee. As amended §§ 2.106(b)(2)(i) and 2.114(b)(2)(i) make clear, any answer may be seasonably amended to plead a counterclaim when the grounds are learned after the original answer is filed.

A number of comments expressed concern that the rules will mandate or encourage speculative counterclaims which the defendant would hope to support by information learned through discovery. A related comment was that proceedings would become complicated and there would be no saving in time or expense. Several comments indicated that an applicant desiring a decision only on the single issue of the registrability of its mark would feel compelled to file a counterclaim.

An applicant or respondent is under an obligation to learn by discovery whether suspected possible grounds for a counterclaim in fact exist if it wants to be sure of the opportunity to file a counterclaim when the grounds existed as of the date of filing the answer. The amount of discovery required to learn of the possible existence of grounds for a counterclaim is not onerous, at least up to the point where an informed decision may be made whether or not to pursue the issue. However, speculative counterclaims should not be filed. Section 2.15 states that the signature of an attorney at law or other person representing a party to a proceeding on a paper filed by him, or the filing of any paper by him, constitutes a certificate that the paper has been read; that its filing is authorized; that to the best of his knowledge, information and belief there is good ground to support it; and that it is not interposed for delay. Rule 11, FRCP, contains language to the same effect and further provides that a pleading signed with intent to defeat the purpose of the rule may be stricken as sham and false.

An applicant or respondent is never under an absolute obligation to plead a counterclaim. If an applicant or respondent desires to have a proceeding which will determine only whether the applicant's or respondent's mark is likely to cause confusion, mistake or deception, the applicant or respondent may refrain from filing a counterclaim (assuming, of course, that there is a choice because the factual basis for a counterclaim is present). The effect of omitting a counterclaim for which the

¹¹ See *P.A.B. Produits et Appareils de Beauté v. Satinine Società In Nome Collettivo di S.A. e.M. Uselline*, 196 USPQ 801 (CCPA 1978).

grounds exist will be that the applicant or respondent, after the case is terminated will thereafter be barred from petitioning to cancel the registration pleaded by the opposer or cancellation petitioner (i.e., the registration identified by number and date of issue in an original notice of opposition or petition for cancellation) on any ground that had matured when the original answer was filed in the first proceeding. This bar will be effective, however, only insofar as a second proceeding between the parties would involve the same mark and the same goods or services of the party (applicant or respondent in the first proceeding) as were the subject of the first proceeding.

Several comments raised the question of the effect of amended §§ 2.106(b) and 2.114(b) when there was no reason for the applicant or respondent to file a counterclaim in the first proceeding because there clearly was no likelihood of confusion, but a later application or registration by the same applicant or respondent, for a specifically different mark or for the same mark but different goods or services, presented a much closer question, and the applicant or respondent, when again met with an opposition or petition for cancellation by the same party relying upon the same registration as had been pleaded in the prior proceeding, would want to counterclaim for cancellation. As indicated previously, the rules that are being adopted have the objective of avoiding a relitigation of issues that could have been determined in a single proceeding. The intent of amended §§ 2.106(b) and 2.114(b) is to bar a later petition for cancellation of the pleaded registration only when the same conflict or controversy is sought to be relitigated. Thus, if a second proceeding concerns a mark or a description of goods or services different from those of the applicant or respondent in the first proceeding, other than trivial, frivolous, or immaterial changes, different issues are presented, the controversy is different, and the compulsory counterclaim rules would have no application; in this situation a petition or counterclaim for cancellation of the opposer's or cancellation petitioner's pleaded registration in a new proceeding would not be barred.

The situations where the compulsory counterclaim rules in amended §§ 2.106(b) and 2.114(b) are most likely to be invoked are those in which a cause of action for the cancellation of an opposer's or cancellation petitioner's registration arises from events or facts which have been concluded or fixed at a time which has passed. When a cause of

action arises from a continuing state of facts, e.g., abandonment as a result of nonuse of a mark, or licensing without adequate control, or because a word has become a common descriptive name, it is conceivable that the compulsory counterclaim rules that are being adopted will be applicable very infrequently or not at all.

One comment stated that an applicant or respondent cannot properly plead damage from an opposer's or cancellation petitioner's registration until the Trademark Trial and Appeal Board or a court "reverses" the examiner's "holding" that a mark, as applied to its goods or services, does not so resemble a previously registered mark as to be likely to cause confusion. This comment misconstrued the decision in *Hyde Park Footwear Co., Inc. v. Hampshire Designers, Inc.*, 197 USPQ 639 (TTAB 1977). An applicant or respondent may consider itself to be damaged by the registration of an opposer's or cancellation petitioner's mark, and is therefore entitled to present evidence and to be heard, notwithstanding that the examiner, with only an application and a prior registration to consider, may have been of the opinion that confusion is unlikely. There is no requirement, and it would be unreasonable to impose one, that an applicant or respondent must await an unfavorable decision of the Board in an opposition or cancellation proceeding (thereby "reversing" the examiner) before the applicant or respondent could assert a likelihood of confusion as a basis for the standing necessary for a cancellation petition against an opposer's or petitioner's registration. Where a party can demonstrate a real interest in the proceeding, it has standing to petition for cancellation.¹²

Another comment suggested that the fee payable in connection with a cancellation be \$25 regardless of the number of registrations sought to be cancelled by the counterclaimant. Section 31(a)(5) of the Trademark Act requires a fee of \$25 on filing a petition for cancellation for each class. Since section 41 of the Trademark Act specifies that the rules and regulations promulgated by the Commissioner be not inconsistent with law, a single fee of \$25 irrespective of the number of registrations or classes for which cancellation is sought cannot be established. However, as a practical matter, the fee for cancellation is usually a very small percentage of the total cost incurred. Even in the extremely rare

case involving numerous pleaded registrations, the antagonists are generally prepared to expend a considerable sum to settle a wide-ranging dispute, and again the fee is a small percentage of the total expense. Thus, the statutory fee is not considered to be a reason not to adopt the compulsory counterclaim rules.

Amended §§ 2.106(b) and 2.114(b) are not applicable to concurrent use proceedings. In such proceedings, the applicant is the nominal plaintiff and only its concurrent use application is involved, so there is no registration against which the named excepted user (the nominal defendant in the proceeding) could counterclaim.

One comment suggested a rule change which was more extensive than the published proposal. After careful consideration, it was decided not to make the rules that are being adopted applicable to concurrent use proceedings or to interference proceedings. When a concurrent use applicant specifies another's application or registration as an exception to the applicant's right of exclusive use, the other party's application or registration is made a part of the concurrent use proceeding and the excepted applicant or registrant is made a party to the proceeding. See §§ 2.42 and 2.99. At the conclusion of the proceeding conducted by the Trademark Trial and Appeal Board pursuant to section 17 of the Trademark Act, the Commissioner may restrict the registration of a registered mark and may register the mark or marks for the person or persons entitled thereto, as the rights of the parties are established in the proceeding. See section 18 of the Trademark Act. Prior to the institution of a concurrent use proceeding, which is between or among the concurrent use applicant or applicants and persons named as excepted users, which include applicants and registrants specified as excepted users, a concurrent use application is published for opposition under section 12(a) of the Trademark Act. Upon publication under section 12(a), any person, including a person named in the application as an excepted user, who believes he may be damaged may file a notice of opposition.

If the opposition to a concurrent use application is prosecuted to a decision, the rights of the parties, including any rights determinable on a counterclaim under amended § 2.106(b), may be decided there. If the rights of the parties are determined in the concurrent use proceeding, section 18 of the Trademark Act authorizes the Commissioner to restrict an applicant's or an excepted

¹² See *Federated Foods, Inc. v. Fort Howard Paper Co.*, 192 USPQ 24 (CCPA 1978); and *Golomb v. Wadsworth*, 201 USPQ 200 (CCPA 1979).

user's application or registration in accordance with the findings and conclusions of the Board. Hence, there is no need to extend the compulsory counterclaim rules to concurrent use proceedings.

Interferences are declared only by the Commissioner and only upon petition showing extraordinary circumstances which would result in a party's being unduly prejudiced without an interference. See § 2.91(a). In practice, an interference is declared only when there are more than two pending applications for substantially the same mark for substantially the same goods or services and the applicant claiming the earliest date of first use is the junior applicant so that he would have to file and prosecute two or more oppositions successfully before his mark could be published for opposition. Since only applications are involved, there is no need for a compulsory counterclaim rule in interference proceedings. All of the rights of the parties will be determined in the interference proceeding.

Text of Rules Adopted

After consideration of the comments received and pursuant to the authority contained in section 1123 of Title 15 of the United States Code and section 6 of Title 35 of the United States Code, Part 2 of Title 37 of the Code of Federal Regulations is amended as set forth below.

1. In § 2.106 paragraph (b) is revised to read as follows:

§ 2.106 Answer.

(b)(1) An answer may contain any defense, including the affirmative defenses of unclean hands, laches, estoppel, acquiescence, fraud, mistake, or prior judgment. When pleading special matters, the Federal Rules of Civil Procedure shall be followed. A reply to an affirmative defense need not be filed. When a defense attacks the validity of a registration pleaded in the opposition, paragraph (b)(2) of this section shall govern. A pleaded registration is a registration identified by number and date of issuance in an original notice of opposition or in any amendment thereto made under Rule 15, FRCP.

(2)(i) A defense attacking the validity of any one or more of the registrations pleaded in the opposition shall be a compulsory counterclaim if grounds for such counterclaim exist at the time when the answer is filed. If grounds for a counterclaim are known to the applicant when the answer to the opposition is filed, the counterclaim shall be pleaded with or as part of the

answer. If grounds for a counterclaim are learned during the course of the opposition proceeding, the counterclaim shall be pleaded promptly after the grounds therefor are learned. A counterclaim need not be filed if it is the subject of another proceeding between the same parties or anyone in privity therewith.

(ii) An attack on the validity of a registration pleaded by an opposer will not be heard unless a counterclaim or separate petition is filed to seek the cancellation of such registration.

(iii) The provisions of §§ 2.111 through 2.115, inclusive, shall be applicable to counterclaims. A time, not less than thirty days, will be designated within which an answer to the counterclaim must be filed.

(iv) The times for pleading, discovery, testimony, briefs or oral argument will be reset or extended when necessary, upon motion by a party, to enable a party fully to present or meet a counterclaim or separate petition for cancellation of a registration.

2. In § 2.114 paragraph (b) is revised to read as follows:

§ 2.114 Answer.

(b)(1) An answer may contain any defense, including the affirmative defenses of unclean hands, laches, estoppel, acquiescence, fraud, mistake, or prior judgment. When pleading special matters, the Federal Rules of Civil Procedure shall be followed. A reply to an affirmative defense need not be filed. When a defense attacks the validity of a registration pleaded in the petition, paragraph (b)(2) of this section shall govern. A pleaded registration is a registration identified by number and date of issuance in an original petition for cancellation or in any amendment thereto made under Rule 15, FRCP.

(2)(i) A defense attacking the validity of any one or more of the registrations pleaded in the petition shall be a compulsory counterclaim if grounds for such counterclaim exist at the time when the answer is filed. If grounds for a counterclaim are known to respondent when the answer to the petition is filed, the counterclaim shall be pleaded with or as part of the answer. If grounds for a counterclaim are learned during the course of the cancellation proceeding, the counterclaim shall be pleaded promptly after the grounds therefor are learned. A counterclaim need not be filed if it is the subject of another proceeding between the same parties or anyone in privity therewith.

(ii) An attack on the validity of a registration pleaded by a petitioner for cancellation will not be heard unless a

counterclaim or separate petition is filed to seek the cancellation of such registration.

(iii) The provisions of §§ 2.111 through 2.115, inclusive, shall be applicable to counterclaims. A time, not less than thirty days, will be designated within which an answer to the counterclaim must be filed.

(iv) The times for pleading, discovery, testimony, briefs, or oral argument will be reset or extended when necessary, upon motion by a party, to enable a party fully to present or meet a counterclaim or separate petition for cancellation of a registration.

Dated: December 8, 1980.

Sidney A. Diamond,
Commissioner of Patents and Trademarks

Approved: January 9, 1981.

Jordan J. Baruch,
Assistant Secretary for Productivity,
Technology and Innovation.

[FR Doc. 81-1376 Filed 1-21-81; 8:45 am]

BILLING CODE 3510-16-M

POSTAL SERVICE

39 CFR Part 111

Application Procedures for Special Bulk Third-Class Rates

AGENCY: Postal Service.

ACTION: Final rule.

SUMMARY: This rule amends Chapter 6 of the Domestic Mail Manual to clarify the Postal Service's administrative practice concerning the application procedures for special (nonprofit) bulk third-class mail rates. It states with greater precision that a separate application for an authorization to mail at the special bulk third-class rates of postage must be filed at each post office where the mailer desires to deposit special rate mailings. The rule also clarifies that a refund of postage paid at the regular bulk third-class rates while a special rate application was pending will only be paid on mailings made at offices where an application was filed. In addition, the rule further clarifies that a cooperative mailing may be made by two or more nonprofit organizations only when each of the cooperating organizations is authorized to mail at the special bulk third-class rates at the post office where the cooperative mailing is deposited.

EFFECTIVE DATE: February 21, 1981.

FOR FURTHER INFORMATION CONTACT: Lynn M. Martin, Office of Mail Classification, (202) 245-4353.

SUPPLEMENTARY INFORMATION: On September 26, 1980, the Postal Service